LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS
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FISCAL IMPACT STATEMENT

LS 6200
BILL NUMBER: SB 195

DATE PREPARED: Nov 14, 1998
BILL AMENDED:

SUBJECT: Phase out of property tax on inventory.

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FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill allows the county fiscal body to phase out the property tax on inventory by allowing assessed value deductions in five increasing gradations over a ten year period. It reduces the property tax levies of all taxing units having assessed value in an adopting county.

The bill also allows the county fiscal body to adopt an ordinance imposing an income tax to recover the net property tax revenue lost by the phase out of the property tax on inventory. It provides that the income tax will increase over the ten year period to recover the revenue lost by each increase of the assessed value deduction. This bill also requires the state to distribute revenue to income tax adopting counties to replace property tax replacement credits and it makes an appropriation.

Effective Date: January 1, 2000.

Explanation of State Expenditures: The State's expense for property tax replacement credits (PTRC) could be reduced under this proposal. If a county adopts the property tax deduction for inventory without imposing the inventory tax replacement income tax, the state would not pay the 20% PTRC on the deducted amount.

The State Department of Revenue would have additional expenses for collecting and distributing the inventory tax replacement income tax under this proposal.

Explanation of State Revenues: The State levies a one cent tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. Based on the estimated loss of inventory assessed value exempted by this proposal, state property tax proceeds will be reduced by a maximum of $102,000 in CY 2001 to approximately $740,000 in CY 2010, assuming that all counties adopt the inventory tax phase-out in the first year available.

Explanation of Local Expenditures:

Explanation of Local Revenues:

Inventory Deduction
This proposal would authorize counties to adopt an ordinance to phase out the property tax on inventory. If adopted, taxpayers would receive a deduction against the assessed value (AV) of their inventory. The amount of deduction is equal to 20% of the inventory in years 1 and 2, 40% in years 3 and 4, 60% in years 5 and 6, 80% in years 7, 8, and 9, and 100% in year 10 and each year thereafter. The county may pass an ordinance to repeal the deduction after the tenth year in which the deduction is in effect.

If a county elects to phase out the property tax on inventory, the maximum levy of each taxing unit in the county would be reduced to reflect the loss of valuation. This would keep the tax burden from shifting from the inventory owners to all other taxpayers via an increased tax rate. Instead of a shift, local units would lose the tax revenue attributable to property tax on inventory. School General Fund maximum levy reductions would be made after computations are made for state tuition support, eliminating any reduction of state support.

The table below shows the *estimated* reductions in maximum levies (gross levies) and inventory taxpayer savings (net levies) *assuming all counties adopt ordinances in CY 2000* to phase out the property tax on inventory beginning in CY 2001. The amount of state PTRC shown is the amount of property tax replacement credit that the state would **save** since maximum levies would be reduced. (*Note: The state would* ***pay*** *a similar amount to local units if the inventory tax replacement income tax under this bill is adopted*.)

(In Millions)					
Year	**Property Tax Year**	**Deduction Percentage**	**Gross Levy Reduction***	**Net Levy Reduction***	**State PTRC***
1	2000 Pay 2001	20%	$108.7	$93.8	$14.9
2	2001 Pay 2002	20%	107.5	93.0	14.5
3	2002 Pay 2003	40%	229.6	199.1	30.6
4	2003 Pay 2004	40%	245.1	213.0	32.2
5	2004 Pay 2005	60%	392.5	341.7	50.8
6	2005 Pay 2006	60%	399.8	348.8	51.0
7	2006 Pay 2007	80%	569.2	497.9	71.3
8	2007 Pay 2008	80%	607.6	532.8	74.8
9	2008 Pay 2009	80%	648.5	570.2	78.3
10	2009 Pay 2010	100%	825.8	727.9	97.9
*- Assumes that all counties would adopt the phase-out in the 1st year available.					

Inventory Tax Replacement Income Tax
Counties that choose to phase out the property tax on inventory may impose the Inventory Tax Replacement

Income Tax, which is created by this bill. The tax would be a local option income tax on the adjusted gross income of individual taxpayers residing in the county. The first-year tax rate may not exceed the rate necessary to replace the lost revenue due to the inventory phase-out.

County Councils are to use data compiled by the State Tax Board to determine the appropriate income tax rate in the first year. The tax rate will automatically increase by amount of the initial rate every two years through the tenth year. The rate may be reduced by ordinance as long as none of the tax revenues have been pledged for the payment of bonds.

Proceeds from the tax are to be deposited in the counties' Inventory Tax Replacement Accounts within the State General Fund. Interest income would be deposited into the Counties' accounts. The Department of Revenue, on recommendation of the State Budget Agency, would estimate and certify the amount of income tax that will be collected during the following year.

Proceeds will be distributed to the adopting counties in equal parts on May 1 and November 1. The tax would take effect on July 1 of the year in which it is adopted. This will allow six months of revenue to build up in the fund so that cash is available to make the distributions. Each taxing unit in an adopting county would receive a proportionate share of the replacement revenue.

In the first year that a county adopts the Inventory Tax Replacement Income Tax, each county would have its income tax rate set so that the new tax doesn't generate any more revenue than the amount of the net levy attributable to the inventory deduction. It is estimated that a 1% income tax would generate about $1.16 billion statewide in CY 2001. This estimate is subject to change after the December, 1998 revenue forecast is released. Assuming that all counties would adopt the Inventory Tax Replacement Income Tax in CY 2001 (the 1st year available), approximately $93.8 million would be needed from this tax to offset the property tax loss. The statewide average of the county income tax rates needed to raise $93.8 million in CY 2001 is estimated to be 0.081% or just under one tenth of one percent. Based on this initial tax rate, the statewide average of the county income tax rates in the tenth year (when the phase-out is complete) would be about 0.4%.

Each individual county's rate would differ from this average depending on the amount of inventory in the county, the property tax rate, and the wealth of the income tax base. It is not currently known if the income tax revenues will grow at the same rate as the loss of property tax. If a county collects more in income tax than it loses in property tax, then there would be a revenue increase in the county. Likewise, if a county receives less revenue from the income tax than it loses in property tax, then there would be a revenue reduction.

The state will pay PTRC on the amount collected via the replacement tax. The PTRC percentage will equal the average county PTRC percentage. PTRC is paid from the Property Tax Replacement Fund, which is supplemented by the state General Fund.

If the income tax is adopted by a county then this bill would have the effect of shifting businesses' property tax on inventory to individuals via the income tax.

State Agencies Affected: State Board of Tax Commissioners; Indiana Department of Revenue; State Budget Agency; Auditor of State.

Local Agencies Affected: All taxing units in adopting counties.

Information Sources: Local Government Database.